

USEITI Update to the International Secretariat: Subnational Payments

Introduction

The purpose of this piece is to provide the EITI International Secretariat with the USEITI Multi-Stakeholder Group's current thinking with regard to the inclusion of subnational payments in USEITI (EITI Standard Requirement 4.2(d)). The USEITI MSG formed the State and Tribal Opt-in Subcommittee to investigate the question of how USEITI can most effectively treat complicated subnational revenue streams and, more specifically, to design an "opt-in" approach for the engagement of subnational entities (as described in the U.S. Candidacy Application).¹ As noted below, Tribes are not strictly "subnational" governments, but we discuss them in this document, along with States, as a matter of convenience.

Following extensive research, consultation, and discussion, the Subcommittee is considering a three-tiered opt-in approach for subnational governments to engage with and contribute to USEITI. This approach will encourage subnational participation by allowing each subnational government to engage to the level practicable for their unique circumstances, given the complexities of U.S. systems of natural resource management. The Subcommittee believes that this approach will maximize engagement of subnational entities, and achieve EITI's goal of transparency of resource revenue information, without imperiling the forward momentum of USEITI.

The USEITI MSG has concluded that, based on research and consultations with states and tribes, that an effort to reconcile payments at a state or tribal level will not be possible or, in some cases, legal. As an alternative, we plan to achieve the goals and requirements of the EITI Standard by utilizing two new and substantial data sources: the Department of the Interior's online data portal, released in December, 2014; and the Contextual Narrative, which will consolidate, explain and share information about subnational resource revenues.

In the United States, land and mineral rights may be owned privately by individuals or corporations, or by federal, state, local, or tribal governments. In addition to the U.S. federal government, there are 50 state governments. There are also 566 federally recognized American Indian tribal governments, which are sovereign governments, but for which the U.S. federal government has a trust responsibility. There are significant differences in the way that extractives revenues are derived, collected, and allocated depending on the entity exercising stewardship of the land and mineral rights. These complexities will be explained in more detail below.

Previous Request for Adapted Implementation

The United States Candidacy Application contained a request for adapted implementation for subnational payments (4.2d). The International Board granted this request, which the USEITI MSG believes is necessary due to the significant practical barriers presented by the United States' complex system of governance.

¹ USEITI Candidacy Application, <http://www.doi.gov/eiti/upload/USEITI-Candidacy-Application-MSG-Approved-2.pdf>

In its Candidacy Application, the USEITI proposed a two-phased approach for subnational participation:

Due to the significant practical barriers resulting from the size and complexity of the state extractive sector, USEITI reporting will partially comply with Rule 4.2(d)'s requirement to disclose material extractive revenues directly collected by states through a two-phased approach: Under Phase I of USEITI's implementation of Rule 4.2(d), publically-available information about state extractives revenue collection will be included in USEITI reports; Phase II of Rule 4.2(d) implementation involves encouraging states to fully participate in USEITI through a voluntary "opt-in" process.²

Phase I of the approach is underway, and the USEITI MSG is very encouraged and excited by its progress.

As noted in the Candidacy Application, a substantial amount of extractive activity and related revenues at the subnational level will be comprehensively covered by USEITI. Much of U.S. federal extractives revenue is derived from federal lands located within the states, in particular in western states where much mineral production is concentrated. It is only those activities and revenues falling under Section 4.2(d) – payments to subnational governments as a result of activities occurring on municipal, state, tribal, or private land – which have proven problematic in the U.S. context and require an adapted solution.

Additionally, through a massive and unprecedented unilateral disclosure by the Department of the Interior, the United States will exceed Rule 4.2(e)'s requirements by representing 100 percent of extractives-specific revenues collected by the federal government and transferred to states and tribes as required by law.³⁴ In addition, the USEITI Contextual Narrative will include extensive county-level data for approximately a dozen counties or clusters of counties with material extraction.

Barriers and Solutions to Subnational Reporting

The Subcommittee's recommendation for a three-tiered opt-in approach in combination with a robust Contextual Narrative expands on "Phase II" of the opt-in strategy outlined in the Candidacy Application, taking into account further investigation conducted by the Subcommittee into the practical barriers necessitating an adapted approach to implementation of Requirement 4.2(d). The direct input of state and tribal government officials and experts has been invaluable in understanding these barriers. Discussions have centered around complexities in U.S. legal and fiscal frameworks, both generally and as specifically related to natural resource management,

² USEITI Candidacy Application, p. 14

³ USEITI Candidacy Application, p. 29

⁴ By law, the U.S. federal government is required to return a percentage of revenues collected by the federal government from oil, gas, and mining activities to the states where the extraction occurs. Thirty five (35) states receive transfers from the federal government covered by these requirements, totaling over \$2 billion in FY 2013. USEITI reporting will disaggregate these transfers to disclose revenues to each state and where applicable, by local government unit. – USEITI Candidacy Application, p. 29-30

such as: the federal structure of the U.S. government, the size and complexity of extractives industries regulation at subnational levels, the array of confidentiality and disclosure laws at various levels, and the unique private vs. public ownership of minerals in the United States.

Implementing EITI in the States

The USEITI MSG has thoroughly considered what would be required for states to fully comply with EITI requirements. The State and Tribal Opt-in Subcommittee determined that the first step is to focus attention on states with material production. Thirty-three states produce oil, gas, or coal, while almost every state produces some non-fossil minerals. Many individual states have larger mineral extractive sectors than entire EITI implementing countries. For example, the state of Texas produces more natural gas than Norway, and eight U.S. states produce more natural gas than Azerbaijan. Implementing EITI at the state level in the United States would, in magnitude, be akin to one government implementing EITI in 50 different countries simultaneously.⁵

The Subcommittee determined that, of the 33 producing states, there are 18 states that are of particular interest given either the magnitude of their mineral production for the in-scope commodities, or the significance of extractive revenues for their state budgets. Those states are: Alaska, Arizona, California, Colorado, Illinois, Kentucky, Louisiana, Montana, Minnesota, Nevada, New Mexico, North Dakota, Oklahoma, Pennsylvania, Texas, Utah, West Virginia, and Wyoming. The MSG is now reaching out to representatives from these states to pursue their participation in USEITI.

Complexities in State Extractives Management

Under the U.S. constitutional framework, state governments have their own legislature, judiciary, administrative bodies, and set of codified laws. They also maintain ownership of some lands and minerals; develop their own taxation and royalty systems applicable to oil, gas, and mining; and directly collect extractive revenues. Each state has a unique revenue-collection and allocation regime, as well as confidentiality and non-disclosure laws prohibiting the release of sensitive financial information, tax payments in particular. Strict rules and penalties attend the circumvention of accounting and tax processes as well as confidentiality laws. Changing or suspending these laws for the purposes of EITI would require fundamentally altering legal and fiscal frameworks.

Along with existing systems for collecting and allocating revenue, the states also feature extensive accounting and auditing functionalities. These systems vary from state to state but are required to be in accord with U.S. government auditing standards. It is common practice for state auditing programs to consult with one another on standards and best practices to ensure consistency to the extent that states' processes differ. The auditing processes in the states are generally considered to be highly proficient, which is evidenced by the fact that state programs are often asked to audit federal revenue streams.

In addition, the multi-stakeholder requirements under the EITI Standard would require each state to meaningfully engage its diverse set of stakeholders. Each participating state would therefore

⁵ USEITI Candidacy Application, p. 29

likely require the establishment of its own multi-stakeholder group, congruent with the USEITI MSG. Each state MSG would require significant amounts of time and funding as they confront the various difficulties attending the EITI effort at the state and local level.

The USEITI MSG remains concerned that the time and resources necessary to fully include subnational participation in the face of the complexities outlined above will unduly imperil the forward momentum of the USEITI effort. After consulting with contacts from the 18 states listed above, the State and Tribal Opt-in Subcommittee is confident that a tiered approach is the best solution to garner subnational participation.

State Extractives Revenue Auditing Case Study: Wyoming

The Wyoming Department of Audit is an independent state agency. The department director is appointed by the state governor, secretary of state, and state treasurer, with the advice and consent of the state senate. The director can only be removed by two of the three elected officials, and only upon a showing of malfeasance, misfeasance, or nonfeasance.

As an internal control to protect from collusion, the Department of Audit does not: receive revenues; have physical custody or control over extractive industry revenues; or have control over or authority for revenue use or disbursement. It also does not do the accounting for or reporting of mineral revenues. Its job is to audit the companies that report and pay on minerals extracted from the State of Wyoming. By verifying that producers properly report in compliance with statutes, regulations, and reporting requirements, these audits protect the public interest.

The Department of Audit's Mineral Audit Division is subject to reviews, quality controls, and oversight, both internal and external. In terms of internal reviews, all audits are subject to a detail review, a supervisory review, and a managerial review. In the case of tax audits, the Wyoming Department of Revenue reviews the audit as well. In the case of federal royalty audits, a document containing the findings, issues, and supporting rationale is circulated to all the audit teams' supervisors for approval and comment. Finally, the document is submitted to the division administrator for final approval and signature, after a group meeting with the supervisors for discussion of the issues.

Then begins the external reviews of the audits. Tax audits are appealed to the Board of Equalization for a hearing, and then appealed to the Wyoming Supreme Court. In the case of federal royalty audits, the Royalty Appeals Program reviews issues if a company appeals an audit. The company can next appeal to the Interior Board of Land Appeals (IBLA) for a review by an administrative judicial body. Next, the company can appeal to Federal District Court for a review of the IBLA decision on the audit. And then, the Federal Appellate Court provides a judicial review of the Federal District Court's decision on the audit.

There are also external reviews of Wyoming's audit program. The State of Wyoming's audit program undergoes external peer reviews, as required by U.S. government auditing standards. These audits are performed by outside private accounting firms, such as Williams, Adley &

Company-DC, LLP, a private independent certified public accounting firm, that is contracted by the Department of the Interior to perform a peer review of the Mineral Audit Division's federal royalty audit function once every three years, covering the preceding three years, ensuring no gap in coverage.

The Department of the Interior also performs reviews, called Attestation Engagements, of Wyoming's contract and billing. The State of Wyoming is subject to and has been included in reviews by the U.S. Department of the Interior's Office of Inspector General and by the U.S. Government Accountability Office.

Implementing EITI in Tribal Governments

The specialized relationship between the U.S. federal government and American Indian tribal governments has necessitated special consideration by the State and Tribal Opt-in Subcommittee.

There are 566 tribal governments recognized by the U.S. federal government. With federally recognized status, tribal governments are eligible for services provided by almost all of the federal agencies, including the Department of the Interior's Bureau of Indian Affairs. Of the 566 tribal governments, 337 tribes are located in the lower 48 states and 229 tribes are located in the state of Alaska. According to the most recent federal data, the 337 tribes are either associated with Indian reservations (with land), are Federally Recognized Tribal Entities (without land), have trust lands for which no reservation exists, or have trust lands that are related to recognized Indian reservations. Tribal governments can also own land, either in fee or trust, outside the boundaries of their reservations. In some states, such as Oklahoma, tribes have extensive land interests, but most do not have reservation status. Generally, tribes or individual Native American allottees that own land also own the mineral interests appurtenant to the land. Of tribes with a land base, a smaller subset have appreciable extractive industries.

The relationship between the U.S. federal government and tribal governments is extraordinarily complex. The U.S. Constitution establishes the power for the U.S. Congress "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."⁶ This provision confirms that tribes have a distinct status in the political fabric of the United States—a status limited only by the plenary power of Congress. It also establishes that tribes are separate and distinct political entities from the 50 states, which generally do not have jurisdiction within the boundaries of Indian reservations.

Numerous U.S. federal government statutes and Supreme Court cases have further defined and clarified the relationship between the federal and tribal governments. Three major principles have evolved:

- 1) Tribes existed as political entities prior to the formation of the United States; therefore tribes have pre-existing or inherent sovereignty.

⁶ The Indian Commerce Clause, United States Constitution, Article I, Section 8.

- 2) The U.S. federal government may reduce or eliminate tribal sovereignty. Individual state governments may not. In addition, tribes retain any sovereignty not expressly reduced or eliminated by the U.S federal government.
- 3) Although sovereign, tribes are also “domestic dependent nations.” This status imposes on the United States a trust responsibility to protect tribes, individual Native Americans, and their assets.⁷

Today, the U.S. federal government has a “nation-to-nation” relationship with tribal governments, in which the government balances the tribes’ sovereignty and right to self-determination with the obligation to protect tribal and individual Indian assets. There is considerable disagreement among tribes, individual Native Americans, and the federal government regarding the meaning, boundaries, and responsibilities of the trust responsibility.

In the extractive industries, the federal-tribal relationship is, if anything, more complex. Complicating factors include:

- 1) Title to the land that makes up tribal reservations is legally owned by the U.S. federal government, in trust, for the exclusive benefit of the tribes.
- 2) Unlike in many other countries, tribes in the United States own the mineral rights associated with their reservation lands. Title to these mineral rights is also held legally by the U.S. federal government, in trust for the appropriate tribe.
- 3) Revenues earned from extracting mineral resources are also trust assets that the U.S. federal government has a responsibility to account for and protect.
- 4) Concomitant to the federal government’s responsibility to protect trust assets is the responsibility to protect information about those assets. This includes protecting information about revenues from extractive activities.
- 5) The Dawes Act of 1887⁸ allotted tribal land to individual Native Americans. Due to generations of intestacy, many of those allotments are now “fractionated,” meaning individual parcels of trust land are owned by dozens, hundreds, or even thousands of individual Native Americans. These individual owners are referred to as “allottees,” and they, jointly and severally, own the mineral rights appurtenant to specific parcels of land. Many reservations include a mix of tribal trust land, individual trust land, and fee land (non-trust).
- 6) Literally dozens of federal statutes, enacted over hundreds of years, regulate the process of leasing tribal or individual trust land for extractive purposes, operating those leases, and paying revenues to the tribal government or individual allottees. Major laws governing this industry on trust land include:
 - a) The Indian Mineral Leasing Act⁹
 - b) The Indian Mineral Development Act,¹⁰ and
 - c) The Energy Policy Act¹¹
 - d) Act of March 3, 1909¹²

⁷ See generally, American Indian Law Deskbook. (University Press of Colorado, 1993)

⁸ The General Allotment Act of February 8, 1887, 24 Stat. 388, ch. 119, 25 USC 331.

⁹ 25 USC §3969, 1938.

¹⁰ 25 USC §§2101-2108, 1982.

¹¹ 119 Stat §594, Title V, authorizing Tribal Energy Resource Agreements, 2005.

- 7) Although the U.S. federal government collects most revenue generated by extractive industries on trust land, the federal government has no ownership rights to that revenue. The government disburses 100 percent of trust revenues to the tribes or individual allottees who have the rights to the extracted commodity.

The practical effect of this complicated legal and fiscal regime is that reporting revenues from trust land under the USEITI process is very difficult. The Department of the Interior does report, on an annual basis, the aggregate national total of revenues that it collects from trust land. It does not, and legally cannot, release data regarding revenue generated for specific tribes or individual Native Americans without the express permission of the tribes or individual allottees in question. Nor can the federal government compel a tribal government or an individual allottee to agree to release of this data.

The only practical activity that the USEITI MSG can undertake is outreach to tribal governments and communities to explain the benefits of EITI and provide each tribal council with the information it needs to decide whether or not to participate in EITI. This outreach is a formidable task. There are 35 tribes to which the Department of the Interior distributes extractive revenue, each with its own elected governing body. In addition, the Department of the Interior disburses extractive revenue to more than 34,000 individual allottees.

Complexities in Tribal Extractives Management

Tribal governments also each have their own governing systems and codified laws. Some tribes have separate executive, legislative, and judicial branches of government; others do not. For most tribes, the U.S. federal government collects, accounts for, and disburses to the tribe, the revenue generated by extractive activities on tribal lands. The federal trust responsibility, as well as exceptions to the federal Freedom of Information Act, prohibit the federal government from disclosing data about any tribe's specific extractive revenues.

Nonetheless, there is an extensive auditing regime for tribal extractive activity revenues. The Federal Oil and Gas Royalty Management Act (FOGRMA), Public Law 97-451, authorizes the Department of the Interior to enter into cooperative agreements with the tribes. There are five Native American Indian Tribes that have cooperative agreements funded under FOGRMA Section 202 with the Office of Natural Resources Revenue to perform audits and compliance reviews of the royalties collected from tribally owned oil, gas and coal mineral resources. These tribal royalty audit programs join the Office of Natural Resources Revenue in providing additional audit coverage of revenues derived from oil, gas and other mineral leases located on tribal lands. The 202 Agreements expand auditing coverage and effectiveness. The Native American Indian Tribal Royalty Auditing Programs must comply with generally accepted U.S. government auditing standards.

The goal of Tribal Royalty Auditing Programs is to ensure the payments are accurate, and comply with applicable lease terms, mineral laws and regulations. The Tribal Royalty Auditing

¹² 25 USC 396

Programs perform audits based upon risk or referral. There can be various types of audit coverages – such as property audits, company audits, issue audits or special terms audits. Tribes that do not have a 202 Agreement solely rely on the Department of the Interior to audit their royalties.

Private Ownership of Land and Mineral Rights

Private ownership of minerals in the United States differentiates the country from nearly all other countries. Private mineral ownership is widespread in the United States, which means that significant extractives industry revenues flow directly to private citizens and corporations rather than to the Federal or subnational governments.¹³ This means that, to the extent that reconciliation of private payments could be legally pursued under current laws, even that effort could not account for a significant portion of revenue in the U.S. system.

Contextual Narrative as Partial Solution

For the variety of reasons described above, reconciliation of payments to subnational governments under the traditional EITI approach is simply not the best solution for increasing transparency and public understanding around extractives in the U.S. system. The marginal value of that reconciliation approach would be grossly disproportionate to the immense effort and commitment it would require to fully implement in the United States. To account for revenues at the subnational level, an unprecedented effort has already been enacted to gather and explain information on revenue from extractives activities at the local, state and Tribal level, through the Contextual Narrative.

The Contextual Narrative and accompanying data portal is a more practicable solution and will make a more important contribution to USEITI than an intensive reconciliation process through EITI at the subnational level. Many states already provide extensive information about their extractive revenues via state websites and other reporting. However, this information is currently dispersed among a large number of state-specific websites and other information repositories. It is, therefore, difficult for the public to access and compare data from multiple states.¹⁴ Through the collection of state data and accompanying explanation of processes and mechanisms attending the management of extractives activities and revenues throughout the country into one unified, imminently intelligible source for citizen edification, the USEITI Contextual Narrative will bring an immense benefit to U.S. citizens, enabling them to empower themselves to evaluate whether these systems are being fairly managed in the best interest of the American people. This will be made possible through enhanced cooperation with subnational governments through USEITI.

Three-Tiered Opt-in Approach

The approach under consideration by the USEITI MSG would involve three defined tiers of subnational engagement:

¹³ Candidacy Application pg 28

¹⁴ Candidacy Application pg 30

- 1) The MSG will establish a point of contact in the subnational government.
- 2) A member of the subnational government will be formally appointed to the USEITIMSG, and
- 3) The subnational government will undertake enhanced Opt-In.

The first tier would involve the subnational government designating an official point of contact for consultation with the USEITI MSG, which would allow the MSG to keep the state or tribe apprised of developments in USEITI, especially with regard to the treatment of subnational governments. The State and Tribal Opt-in Subcommittee has determined that establishing a line of communication with subnational governments is a critical first step.

At the second tier of engagement, a state or tribal official would be formally appointed to the USEITI MSG as a representative of their subnational government. The MSG is encouraged by and has benefited greatly from the appointment of MSG members from the states of Wyoming and California and the Shoshone & Arapaho Tribes (in addition to several MSG members who represent state and tribal interests at-large.)

The third tier of subnational engagement would involve the state or tribe directly assisting the MSG and Independent Administrator in identifying sources of existing data on extractives activities within their state or tribal boundaries, as well as providing their expertise in creating comprehensive but digestible textual explanations of the unique legal and fiscal frameworks governing extractives industries and revenue management in each state. This third tier would not require the state or tribe to fully comply with the reconciliation component of EITI, but would entail a formal commitment from a state official to work with USEITI to collect that state's legally available data and integrate it into the USEITI report. The State and tribal Opt-In Subcommittee has determined that leveraging the expertise of state and tribal government personnel in identifying existing data sources and regulatory frameworks will prove to be a substantial and critically important contribution to the quality, breadth, and meaningfulness of the Contextual Narrative and the USEITI report more generally.

The State and Tribal Opt-in Subcommittee is optimistic that many states and tribes will opt-in to "third-tier" engagement, but anticipates that securing this level of engagement for all of the 18 material states and 35 material tribes will be exceedingly difficult due to the significant practical barriers identified in the U.S. Candidacy Application and expanded upon in this thought-piece. The hope and expectation is that using this tiered opt-in approach will garner the maximum possible voluntary engagement by subnational entities.

Conclusion

In light of all the complexities described above, the Subcommittee concluded that the three-tiered opt-in, in combination with a robust Contextual Narrative as described, represents the best possible solution for the inclusion and treatment of subnational extractives activities. USEITI MSG believes that the approach outlined in this update will allow USEITI to successfully contend with the complexities of the U.S. system, mitigate potentially adverse outcomes, and provide a framework under which USEITI at the subnational level can flourish.

The United States understands well that EITI is an intensive initiative requiring a strong willingness and commitment to implement. It is as a result of the United States' dedication to open government and transparency that the USEITI MSG has endeavored to find a workable solution to implement EITI in the context of the U.S. It is the sincere hope of the MSG that this approach will allow the benefits of EITI to be extended to the United States and that by joining the initiative, the United States will contribute to openness and transparency in the world as an equal partner with our fellow EITI implementing countries.

If the EITI Secretariat has any questions or comments, we are happy to discuss them with you.